VZCZCXRO1576
PP RUEHRG
DE RUEHBR #1866/01 2481857
ZNR UUUUU ZZH
P 051857Z SEP 06
FM AMEMBASSY BRASILIA
TO RUEHC/SECSTATE WASHDC PRIORITY 6570
INFO RUEHRG/AMCONSUL RECIFE 5397
RUEHSO/AMCONSUL SAO PAULO 7936
RUEHRI/AMCONSUL RIO DE JANEIRO 2800
RUEHSG/AMEMBASSY SANTIAGO 5753
RUEHBU/AMEMBASSY BUENOS AIRES 4248
RUEHAC/AMEMBASSY ASUNCION 5645
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E.O. 12958: N/A
TAGS: ECON PGOV PREL EFIN EINV BR
SUBJECT: BRAZIL: AMBASSADOR DISCUSSES REFORM AGENDA WITH FINANCE
MINISTRY INTERNATIONAL SECRETARY

This cable is sensitive but unclassified, please protect accordingly.

¶1. (SBU) Summary: In an August 23 meeting with the Ambassador, Ministry of Finance (Fazenda) International Secretary Luiz Pereira made the point that, with the macroeconomic framework for growth in place, it was time for Brazil to focus ever more on the microeconomic reforms and business environment issues necessary to boost productivity and growth. The Ambassador suggested that the USG and American private sector could support the GoB's reform agenda. Both the Ambassador and Pereira noted the transformational potential of ethanol for the economies of many countries in the Caribbean and Central America. With respect to any potential tax treaty, Pereira stated that the principle issue for Brazil would be revenue flows. End Summary

¶2. (SBU) In a relaxed August 23 meeting, Fazenda International Secretary Luiz Pereira noted to the Ambassador that Brazil had come

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a long way in creating the macroeconomic conditions for stability and growth. Four years ago the private sector had substantial doubts about candidate Lula da Silva's ability to conduct a coherent economic policy. His success in so doing showed that the commitment to sound policy spanned the political spectrum in Brazil as this commitment had been maintained for over a decade. There is a clear perception of the benefits of stabilization, Pereira affirmed, which has created a fair degree of consensus on the general outlines economic policy.

¶3. (SBU) The time has come, Pereira stated, for Brazil to focus on the reforms necessary to increase productivity and potential growth. This will require a more complex set of reforms, at the microeconomic level, Pereira argued, not only in Brazil but across Latin America as a whole. Pereira explained, in broad

brush-strokes, the Lula Administration's microeconomic reform agenda, which included bankruptcy law reform, Public Private Partnerships (PPP) legislation passed in 2004 and legislation to promote research and development. The GoB also had undertaken measures to reduce collection risks for lenders and improve the workings of the financial markets. Brazil's financial sector, Pereira noted, would need to become more competitive as it adjusted to life with lower real interest rates. Pereira stated the GoB was working to introduce a flat tax on small businesses and that the GoB well aware that social security reform was necessary.

¶4. (SBU) The Ambassador suggested that the USG and the private sector might be able to support the GoB as it pushes forward with its reform agenda. There was interest from both the USG and private sector in the promoting infrastructure investment through PPPs. The Russell Equity 20/20 group was planning major Brazil-focused events in the coming year and New York Stock Exchange Chairman John Thain was planning a trip as well. Among others, these contacts should create opportunities to discuss what sort of improvements could be made to the business environment. The Ambassador noted that the U.S. Small Business Administration (SBA) had worked closely with the government of Mexico on an SME program, the results of which the GoB might find could serve as an example of what could be done. He suggested that the Treasury-Fazenda Group for Growth could usefully consider some of these issues. The Ambassador noted that Secretary Paulson strong private sector background on these issues, including PPPs, could invaluable.

Ethanol

¶5. (SBU) The Ambassador and Pereira agreed on the transformational potential that ethanol production could have on many of the smaller economies of the Caribbean and Africa. Sugar-cane based ethanol had

the potential, Pereira noted, to provide jobs, reduce oil imports and enhance energy security. The issue was one where bilateral cooperation made eminent sense, he said.

Tax Treaty

¶6. (SBU) Noting that there have been ongoing informal contacts about the potential for a Bilateral Tax Treaty (BTT), Pereira said that the fundamental issue for the Finance Ministry is the issue of revenues. The Ambassador observed that in improving the climate for business in both countries, a BTT could enhance tax revenues over time. Moreover, as Brazilian investment in the U.S. was growing apace, there would be substantial Brazilian private sector benefit as well.

¶7. (SBU) Comment: While Pereira is correct that the GoB has a well-articulated reform agenda, he dwelt very little on how much difficulty the GoB has had in moving reforms through Congress in the last two years. With so little progress since December 2004, much remains to be done. This places a certain urgency in pushing reforms through the Congress early in the next administration, when the winner's mandate and political capital is at its strongest. To a great extent, this is not a question of defining what needs to be done, which Brazilian policy makers are well aware of, but one of working to enhance the public debate over these measures. A key issue is the tendency of the Brazilian political system to water down reforms. To the extent that the USG can bring resources to bear, whether it be through supporting private sector dialogue with the GoB, through high-level visitors or through discreet behind-the-scenes contacts, we may have success in tipping the balance towards more ambitious measures. In either case, it is time not simply to praise Brazil for what it has accomplished on macroeconomic stabilization, but for the USG to support it with some specific policy and knowledge-based expertise to support its microeconomic reform agenda.

SOBEL